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Current Handling: SBU
Document Number: 1999BOGOTA03445

Channel: n/a

RADICAL PLAN TO BOLSTER FOREIGN INVESTMENT IN COLOMBIA'S LANGUISHING HYDROCARBON SECTOR. HE AIMS TO SHOWCASE HIS REFORM INITIATIVE AT THE APRIL 24 ENERGY CONFERENCE IN CARTAGENA WITH SECRETARY OF ENERGY RICHARDSON IN ATTENDANCE.

2. (U) THE FIRST PHASE OF REFORM CALLS FOR A MORE LENIENT ROYALTY REGIME, WHILE THE SECOND PHASE WILL INVOLVE SIGNIFICANT REDUCTIONS IN ECOPETROL'S PARTICIPATION IN "ASSOCIATION CONTRACTS." WITH THIS PROPOSAL, MINISTER VALENZUELA HOPES TO GUARANTEE PRIVATE OIL COMPANIES AT LEAST A 15 PERCENT RETURN ON INVESTMENT (ROI) FOR 90 PERCENT OF THEIR UP-STREAM PROJECTS. POST CONFIRMED THE DETAILS OF THE REFORM PACKAGE DURING AN AMBASSADORIAL MEETING WITH MINISTER VALENZUELA ON APRIL 8, 1999.

3. (SBU) PRIVATE OIL COMPANIES HERE SAY THAT MINISTER VALENZUELA'S SCHEME IS AN ENORMOUS STEP IN THE RIGHT DIRECTION. ANALYSTS RECKON IT LIKELY TO PASS MUSTER IN THE COLOMBIAN CONGRESS AND ECOPETROL'S (THE STATE OIL COMPANY) BOARDROOM. MINISTER

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VALENZUELA TOLD THE AMBASSADOR THAT HE BELIEVES THERE IS AN 85 PERCENT CERTAINTY THAT CONGRESS WILL PASS HIS ROYALTY PROPOSAL. NEVERTHELESS, THE REFORM PACKAGE MAY NOT BE SUFFICIENT TO GENERATE THE HIGH LEVELS OF NEW INVESTMENT MINISTER VALENZUELA DESIRES. END SUMMARY.

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"MUCH TO OUR HORROR, THE OIL INDUSTRY IN COLOMBIA IS DISAPPEARING"
- MINISTER VALENZUELA

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4. (U) PRIVATE SECTOR SOURCES AS WELL AS ENERGY MINISTRY OFFICIALS TOLD ECONOFF THAT ENERGY MINISTER LUIS CARLOS VALENZUELA'S PROPOSAL TO IMPROVE COLOMBIA'S ENERGY-INVESTMENT CLIMATE IS MOTIVATED BY THE GENERAL PREDICTION THAT HIS COUNTRY WILL OTHERWISE BECOME A NET OIL-IMPORTER BY 2006. SINCE ASSUMING OFFICE LAST AUGUST, VALENZUELA HAS WORKED CLOSELY WITH THE COLOMBIAN PETROLEUM ASSOCIATION (ACP) DESIGNING A STRATEGY TO ENSURE HYDROCARBON SELF-SUFFICIENCY (AND THE ACCOMPANYING BOOST TO COLOMBIA'S BUDGET AND BALANCE OF PAYMENTS) WHICH CAN GAIN ADEQUATE SUPPORT IN CONGRESS AND ECOPETROL.

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A LOOK AT THE PLAN

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5. (U) THE MINISTER'S PLAN CONSISTS OF TWO ESSENTIAL PARTS: 1) TO MAKE THE ROYALTY REGIME MORE FLEXIBLE; AND 2) TO INCREASE

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FOREIGN OIL COMPANIES' PRODUCTION SHARE, UNDER THE SO-CALLED
"ASSOCIATION CONTRACTS" WITH COLOMBIAN STATE COMPANY ECOPETROL.
UNDER THE CURRENT ASSOCIATION CONTRACTS, PRIVATE OIL COMPANIES FACE
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A FLAT 20% ROYALTY, REGARDLESS OF PRODUCTION LEVELS, AND A FIXED
50% PRODUCTION SHARE. (NOTE: BY COMPARISON, ACCORDING TO
ECOPETROL, ROYALTIES VARY BETWEEN 5 PERCENT AND 12 PERCENT IN
BRAZIL, ARGENTINA, NIGERIA AND TURKEY. END NOTE).

STEP 1: ROYALTY REFORM

6. (U) AS A RIDER TO THE PASTRANA GOVERNMENT'S 1998-2002
"NATIONAL DEVELOPMENT PLAN" BILL, MINISTER VALENZUELA ATTACHED A
MORE FLEXIBLE, COMPETITIVE ROYALTY REGIME. INSTEAD OF THE FLAT 20
PERCENT ROYALTY, THE PROPOSED REGIME CALLS FOR A SLIDING SCALE
APPROACH WHEREIN: A 5 PERCENT ROYALTY WOULD APPLY TO 5,000 OR LESS
BARRELS/DAY (BPD); A 5 PERCENT TO 20 PERCENT ROYALTY FOR 5,000 TO
200,000 BPD; A 20 PERCENT ROYALTY FOR 200,000 TO 400,000 BPD; A 20
PERCENT TO 25 PERCENT ROYALTY FOR 400,000 TO 600,000 BPD; AND A 25
PERCENT ROYALTY FOR ANY FIELD WITH PRODUCTION OVER 600,000 BPD.
THIS PROPOSED REGIME WOULD APPLY TO NEW CONTRACTS AND TO NEW
DISCOVERIES UNDER OLD CONTRACTS, BUT NOT TO EXISTING WELLS.

STEP 2: REDUCE ECOPETROL'S SHARE

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	EB-00	EXME-00	E-00	FBIE-00	UTED-00	FRB-00	H-01
	TEDE-00	INR-00	ITC-01	LAB-01	L-01	ADS-00	NSAE-00
	OES-01	OMB-01	OPIC-01	PA-00	PM-00	PRS-00	P-00
	SP-00	SSO-00	STR-00	TRSE-00	USIE-00	EPAE-00	PMB-00
	DSCC-00	DRL-02	G-00	NFAT-00	SAS-00	/014W	

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Channel: n/a

DEPT OF ENERGY WASHDC
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AMEMBASSY CARACAS
AMEMBASSY MEXICO
AMEMBASSY BRASILIA
AMEMBASSY QUITO
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USDOC FOR 4331/IEP/OLA/AND/GAISFORD

E.O. 12958: N/A

TAGS: EPET, ENRG, ECON, EINV, BEXP, PGOV, PINR, PREL, CO

SUBJECT: ENERGY MINISTER VALENZUELA'S GAMBIT - REFORM OIL POLICY

7. (SBU) THE BUZZ IN THE ENERGY MINISTRY, THE PRESS AND LOCAL OIL- COMPANY BOARDROOMS IS THAT, ASSUMING CONGRESS PASSES THE REVISED ROYALTY REGIME, MINISTER VALENZUELA WILL PROCEED TO SEEK A REDUCTION IN ECOPETROL'S PARTICIPATION: FROM 50 PERCENT TO 5 PERCENT FOR SMALL FIELDS (LESS THAN 50 MILLION BARRELS OF RESERVES) AND FROM 50 PERCENT TO 30 PERCENT FOR ALL OTHER FIELDS. (CURRENTLY, ONLY LIBYA REQUIRES HIGHER PARTICIPATION LEVELS THAN COLOMBIA, OUR LOCAL SOURCES CLAIM.)

8. (SBU) AS WELL, MINISTER VALENZUELA WILL PROPOSE DOUBLING THE "R-FACTOR" -- THE CURRENT INCENTIVE FOR INACTIVE ASSOCIATION CONTRACTS -- FROM ONE TO TWO. THE "R-FACTOR" IS THE PRIVATE OIL COMPANY'S RATIO OF INCOME TO EXPENSE. UNDER CURRENT POLICY, ECOPETROL AND THE ASSOCIATE SHARE PRODUCTION EQUALLY (50-50) UNTIL THE "R-FACTOR" IS ONE. ONCE "R" EXCEEDS ONE, ECOPETROL'S PARTICIPATION BEGINS TO INCREASE, BASED ON A SLIDING SCALE THAT REWARDS ECOPETROL WITH A GREATER SHARE OF PRODUCTION AS THE ASSOCIATE'S INCOME RAISES RELATIVE TO EXPENSE. SHOULD MINISTER VALENZUELA SUCCEED IN MOVING THE "R-FACTOR" TO TWO, HE EFFECTIVELY POSTPONES REDUCTION OF THE ASSOCIATE'S SHARE. (NOTE: ECOPETROL ONLY APPLIES THE "R-FACTOR" TO COMMERCIAL FIELDS ONCE THEIR ACCRUED PRODUCTION EXCEEDS 60 MILLION BARRELS; BEFORE THAT POINT ECOPETROL DOES NOT APPLY THE "R-FACTOR" REGARDLESS OF THE INCOME/EXPENDITURE RATIO. END NOTE). THIS PROPOSAL WOULD APPLY ONLY TO NEW

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CONTRACTS.

9. (SBU) VALENZUELA'S GOAL IS TO PROVIDE PRIVATE OIL COMPANIES WITH A HIGH PROBABILITY OF A 15 PERCENT ROI ON 90 PERCENT OF THEIR FIELDS. IN LINE WITH THIS PURPOSE, VALENZUELA WILL REPORTEDLY WAIT TO FORMALLY PROPOSE ANY CHANGES TO ECOPETROL'S PARTICIPATION LEVEL UNTIL HE HAS SPECIFIC KNOWLEDGE OF THE NEW ROYALTY SCHEDULE (CONGRESS COULD APPROVE A LESS COMPETITIVE ROYALTY REGIME THAN THAT PROPOSED BY VALENZUELA, WHO WOULD THEREBY THEN NEED TO CUT ECOPETROL'S SHARE BY A GREATER AMOUNT SO AS TO HIT HIS 15 PERCENT ROI OVERALL TARGET).

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... AND THE PLAN'S PROSPECTS FOR PASSAGE
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10. (SBU) WITH RESPECT TO ROYALTIES, OUR HANDICAPPERS IN THE OIL SECTOR TELL US THEY THINK CONGRESS WILL LIKELY PASS, INTACT, MINISTER VALENZUELA'S PROPOSAL BEFORE THE END OF MAY. REASONS FOR THIS OPTIMISM INCLUDE: 1) THAT THE REFORM PACKAGE MOVED QUICKLY THROUGH THE 3RD AND 4TH CONGRESSIONAL COMMISSION AS PART OF THE NATIONAL PLAN; 2) SENATOR SERRANO, THE KEY OIL LEGISLATOR AND HEAD OF THE 5TH COMMISSION ON ENERGY, HAS NOT UTTERED A WORD OF OPPOSITION IN EITHER THE CONGRESS OR MEDIA; 3) THE OIL UNION, "USO", IS PREOCCUPIED WITH ECOPETROL SALARY NEGOTIATIONS; AND 4) THE ABSENCE OF ANY SUBSTANTIVE PEACE DIALOGUE WITH THE "OIL-SENSITIVE" ELN GUERRILLA MOVEMENT LESSENS THE DANGER THAT THE GOC WILL BE POLITICALLY TEMPTED TO NEGOTIATE AWAY ROYALTY REFORM, OR REDUCTIONS IN ECOPETROL PARTICIPATION, IN PURSUIT OF PEACE.

11. (SBU) WITH RESPECT TO REDUCTIONS IN ECOPETROL'S SHARE, OUR
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SOURCES ARE EQUALLY OPTIMISTIC THAT MINISTER VALENZUELA WILL WIN THE APPROVAL OF ECOPETROL'S BOARD OF DIRECTORS. THEIR PROGNOSIS IS BASED ON THE AMICABLE MAKE-UP OF THE EIGHT-MEMBER BOARD, WHICH INCLUDES TRANSPORTATION MINISTER MAURICIO CARDENAS (A CLOSE FRIEND OF VALENZUELA AND KEY CONFIDANT OF PRESIDENT PASTRANA), TWO HIGH-LEVEL DEPUTIES FROM PRESIDENT PASTRANA'S OFFICE, AND MINISTER VALENZUELA HIMSELF AS CHAIRMAN.

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... AND THE RESPONSE FROM PRIVATE OIL COMPANIES
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12. (U) ECONOFF SPOKE WITH ALEJANDRO MARTINEZ, PRESIDENT OF THE COLOMBIAN PETROLEUM ASSOCIATION (ACP), ABOUT HIS REACTION TO VALENZUELA'S REFORMS. HE STATED: "MINISTER VALENZUELA HAS DONE EXCELLENT HOMEWORK. HIS PROPOSAL IS VERY POSITIVE. OUR ECONOMIC MODELS SHOW HIGH PROBABILITY OF MAKING BETWEEN 8 PERCENT AND 16 PERCENT ROI ON 90 PERCENT OF COLOMBIA'S FIELDS." (NOTE: THIS IS BASED ON AN INDUSTRY ASSUMPTION THAT 90 PERCENT OF COLOMBIA'S FIELDS CONTAIN LESS THAN 50 MILLION BARRELS IN RESERVES AND, THEREFORE, WOULD QUALIFY FOR A 5 PERCENT ROYALTY AND 70 PERCENT ASSOCIATE SHARE. END NOTE).

13. (SBU) MARTINEZ ADDED, HOWEVER, THAT MINISTER VALENZUELA'S

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	EB-00	EXME-00	E-00	FBIE-00	UTED-00	FRB-00	H-01
	IM-01	TEDE-00	INR-00	ITC-01	LAB-01	L-01	ADS-00
	NSAE-00	OES-01	OMB-01	OPIC-01	PA-00	PM-00	PRS-00
	P-00	SP-00	SSO-00	STR-00	TRSE-00	USIE-00	EPAE-00
	PMB-00	DSCC-00	DRL-02	G-00	NFAT-00	SAS-00	/015W

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 FM AMEMBASSY BOGOTA
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 DEPT OF ENERGY WASHDC
 INFO USDOC WASHDC
 AMEMBASSY CARACAS
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TAGS: EPET, ENRG, ECON, EINV, BEXP, PGOV, PINR, PREL, CO
SUBJECT: ENERGY MINISTER VALENZUELA'S GAMBIT - REFORM OIL POLICY

PROPOSAL CONTAINS ONE SERIOUS FLAW: IT INTRODUCES LESS ATTRACTIVE TERMS FOR LARGER FIELDS (E.G., OVER 400,000 BPD). WHILE THE REALITY IS THAT IN 70 YEARS OF COLOMBIAN OIL EXPLORATION ONLY TWO FIELDS HAVE GENERATED MORE THAN 200,000 BPD IN PRODUCTION, IT IS THE POSSIBILITY OF HITTING THE "MOTHER LODE" (I.E., THE NEXT CUSIANA FIELD) THAT BRINGS THE BIG OIL COMPANIES AND THEIR CHECKBOOKS TO THE MARKET. ACCORDING TO MARTINEZ, WITHOUT PROPER INCENTIVES FOR SUCH FIELDS, LARGE MULTINATIONALS WILL REMAIN RELUCTANT TO INVEST HEAVILY IN COLOMBIA. "THEY WON'T COME", HE SAID. ACP HAS PROPOSED ITS OWN REGIME THAT WOULD MAINTAIN THE 20 PERCENT ROYALTY ON FIELDS GREATER THAN 400,000 BPD, BUT MARTINEZ IS NOT/NOT CONFIDENT OF CONGRESSIONAL PASSAGE OF THIS PROPOSAL.

14. (SBU) ECONOFF ALSO SPOKE WITH OFFICIALS FROM SEVERAL U.S. OIL COMPANIES ABOUT THEIR REACTION TO MINISTER VALENZUELA'S REFORMS. THEIR COMMENTS CLOSELY RESEMBLED THOSE OF MARTINEZ; NONE OF THE OFFICIALS WOULD PREDICT FUTURE INVESTMENT IN RESPONSE TO MINISTER VALENZUELA'S PROPOSAL.

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COMMENT

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15. (SBU) COMMENT: BASED ON PRIVATE-SECTOR REACTION WE HAVE HEARD, EVEN WITH SUCCESSFUL IMPLEMENTATION OF MINISTER VALENZUELA'S REFORMS IT IS UNREALISTIC TO EXPECT THAT PRIVATE OIL COMPANIES NOT CURRENTLY PRESENT IN COLOMBIA WILL ENTER WITH SUBSTANTIAL INVESTMENT IN EXPLORATION AND PRODUCTION. THIS SEEMS EQUALLY TRUE FOR COMPANIES THAT HAVE A PRESENCE HERE BUT HAVE CEASED UPSTREAM OPERATIONS.

16. (U) YET, THE SAME MAY NOT BE SAID OF COMPANIES ALREADY PRESENT IN COLOMBIA WITH HEAVY SUNK COSTS IN UPSTREAM OPERATIONS.

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IN THESE CASES, VALENZUELA'S REFORM PACKAGE COULD ENTICE APPRECIABLE INVESTMENT IN EXPLORATION AND PRODUCTION. INDEED, UNDER THOSE CONDITIONS THE SOPHISTICATED ECONOMIC MODELS ON WHICH THESE COMPANIES PREDOMINANTLY BASE THEIR INVESTMENT DECISIONS APPARENTLY SUGGEST LUCRATIVE RETURNS ON INVESTMENT. STILL, WE HAVE HEARD NO TALK YET FROM THE ACP AND ITS CONSTITUENTS OF ANY POST-REFORM INVESTMENT GAME PLAN; AND UNTIL THAT HAPPENS, COLOMBIA WILL REMAIN CONDEMNED TO BECOME A NET OIL-IMPORTER BY 2006. END COMMENT.

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POSTSCRIPT

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17. (U) THE AMBASSADOR AND ENERGY MINISTER VALENZUELA DISCUSSED THE LATTER'S PLANS TO REFORM COLOMBIAN OIL POLICY IN AN APRIL 8, 1999, MEETING. AT THIS MEETING, VALENZUELA DIRECTLY CONFIRMED THE

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DETAILS OF HIS PROPOSAL AND SAID HE WAS 85 PERCENT CERTAIN THAT CONGRESS WOULD PASS (PERHAPS WITH MINOR REVISIONS) HIS ROYALTY PROPOSAL. VALENZUELA STATED THAT EVEN IF CONGRESS TINKERED WITH HIS PROPOSAL, HE WOULD MAKE UP THE DIFFERENCE THROUGH FURTHER REDUCTIONS IN ECOPETROL'S SHARE (CF. PARAGRAPH 9).

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